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41

June 28, 1996

Dr. David Berry
ARIZONA CORPORATION COMMISSION
1200 W. Washington
Phoenix, AZ 85007

Subject: DOCKET U-0000-94-165

Dear Dr. Berry:

Calpine Corporation would like to submit the following points for the Commission's consideration.

The large, regulator protected, vertically integrated monopoly utilities have placed a priority on delaying retail competition in Arizona, as well as the rest of the United States. These IOUs will attempt to delay the inevitable in order to collect as much money from their presently captive customers as the present regulatory structure will allow. The IOUs that have management styles that have anticipated the opportunities created by open access are quietly 'waiting in the wings' to implement their well-devised plan to win customer base from the utilities that have spent their energies fighting against, not posturing for retail open access.

SRP, being self governing, has a differing set of problems. Do they have an *obligation to serve*? Or, have they been operating under an *opportunity to serve* these many years. Can they collect on their stranded investment? Does the quasi-municipal status that SRP has so closely protected for years, disallow their claim to collect funds that may only be available to those public service companies that truly had a regulatory compact?

Public Power has the problem of the stockholder and ratepayer being the same entity. Public Power is usually limited in the retail arena by municipal boundaries. Companies like Calpine are an answer to how the Public Power entity may take advantage of the open access market while preserving their ability to keep their customer base. We hope the following comments will be of help to the Commission's process.

Stranded Investment

Stranded investment is no reason to stall open access, but we anticipate that state regulators will get stuck in the stranded investment quicksand caused by monopolies trying to protect their position. To avoid the sinkholes, we suggest that the Commission address the stranded investment issue in four parts.

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1. Accept the argument that there is some stranded investment.

2. Develop the mechanism for collecting stranded investment payments.

3. Establish the responsibility for paying for stranded investment.

4. Determine the actual dollar amount of prudent, unrecoverable stranded investments.

The Mechanism

Open access has spawned the term 'Stranded Investment,' a term created by the utility industry to disguise what used to be called 'Bad Investment.' It didn't matter if you had bad investments in a cost plus environment. In fact, in many cases, the bad investments actually produced a premium for the badly-investing utility. Customers are paying for these bad investments now in their bundled electricity rates. When the utility unbundles its cost and pricing structure, the Commission should require the utility to designate how much of the utility bill was dedicated to paying for these management mistakes. That amount should be designated as the stranded investment payment in the new unbundled electricity bill.

The Responsibility

Two factors should cause the bad investment number from the old bill to not equal the stranded investment number in the new bill.

1. How much of that bad investment should be assumed by the stockholder, and not be passed on to the ratepayer. After all, it was the stockholder that elected the management that made the bad investments.

2. Open access created the need to designate this bad investment as stranded investment. Open access also created market opportunities for these utilities that they would never have received in the old regulated environment. These pluses created by open access should balance out like amounts of minuses created by the same situation.

In a study commissioned by the Massachusetts Attorney General, the utilities' stranded investment claim was less than their opportunity potential from new neighboring electricity markets. These markets have been closed to competition in the past. In the worst case scenario, the utility stockholders investment still increased in value. Is not the utilities claim for the need for stranded investment collection tied directly to their desire to protect their stockholders? In the Massachusetts study, when allowed to collect stranded investment and take advantage of new market opportunities, the stock more than doubled, at the expense of the ratepayer.

The Amount

The assets that the utilities are calling stranded, from losing captive customer base, are not necessarily stranded indefinitely. As the utility takes advantage of open access opportunities, they should be able to serve new load in other utilities control areas that they were restrained from serving in the old environment. The possibility that the stranded generation could be sold on the wholesale market exists. The wholesale market does not produce the big profits available in the retail market; but, the Commission is not in the business of guaranteeing the utilities that they will make the same profits in an open market as in the cost-plus market of the past. If the utility can sell the asset for cost on the wholesale market, it is not stranded. It should be noted that some utilities have include stranded profits in their stranded investment numbers. Regulatory assets, or assets that the utility was mandated to build or purchase, are 100% true stranded investments to the extent that they are uneconomical in the market. Assets that were deemed reasonable and prudent, or used and useful, should not be included as being regulatory assets. The majority of stranded investment in the US is wrapped up in 34 nuclear units that came on line since 1984. Not one of these nuclear units was mandated and, in most cases, these units were found to be uneconomic long before they were completed. Economically, many of these nuclear units would have been more economic if they had not been completed. That option was taken by the few far-sighted utilities, one utility even re-engineering their unit for coal consumption. The completion of the Palo Verde Nuclear Generating Station was a calculated risk taken by utility management over the economic indicators that pointed to some other option. The recent downturn in energy prices makes the PVNGS an even more visible mistake, not a regulatory mistake, but a management mistake. Electricity load growth in Arizona is in the 4% per year range and will eventually consume the assets that are considered stranded in 1996. This 'growth caused' decrease in true stranded assets needs to be included in the formula used to determine any stranded investment payback.

Initiating Retail Open Access

There has been a trend in the regulatory arenas in the US to try and figure out how to regulate this deregulated generation market. Calpine exhorts the Commission to avoid this trap. The market forces, that have made the US economy the best economy in the world for the consumer, will take care of the consumer. Phasing in open access is regulating a deregulated market. Phasing in open access will inevitably promote cost shifting to the small commercial and residential consumer. In the words of Commissioner Vicki Bailey of the Federal Energy Regulatory Commission," Regulation is the surrogate of competition. Where competition exists, regulation must be eliminated".

The advancement of the technology needed for the small customer to take advantage of an open access market will be enhanced by across-the-board open access. If the small commercial and residential customers have the same access to the generation markets that the large industrials have, the entrepreneurial American business environment will develop and implement the access method sooner than if the small customer has to wait for the turn of the century to participate. Technology should determine who can participate in the open access market; and, technology will advance faster if the market is open to all consumers.

If Calpine can be of assistance to the Commission or Commission staff, please call Mike Rowley at 408-995-5115 at our San Jose office, or 602-668-2892 in Arizona.

Sincerely,

CALPINE POWER SERVICES COMPANY

Michael W. Rowley
Special Projects

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